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No. 341

In the

Supreme Court of the United States

H. L. DILLON, JR., *et al.*, *Petitioners,*

v.

MICHEL T. HALBOUTY, *et al.*, *Respondents.*

Petition for a Writ of Certiorari
to the
Supreme Court of Texas

BRIEF OF RESPONDENT, PAN AMERICAN PETROLEUM CORPORATION, IN OPPOSITION

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GENERAL INDEX

	Page
Function and Jurisdiction of the Railroad Commission of Texas in the administration of the oil and gas conservation laws	2
Function and Jurisdiction of the Texas Courts relative to orders adopted by the Railroad Commission of Texas	2
Fair share of the production	3
The judgment of the Supreme Court of Texas	5
Weighing the evidence	6
Nonfederal question	6
Petitioners drilled their wells at their own risk	6
The Commission or Courts cannot assure the Petitioners a profit	9
The offer of unitization to the Petitioners	11
The matter in controversy has not reached the point of finality	13

Page

Arkansas Fuel Oil Co. v. Reprimo Oil Co., 91 S. W. 2d 381 (Ref. 1936) 4

Atlantic Oil Production Co. v. Railroad Commission, 85 S. W. 2d 655 (W.E. Dis. 1935) 4

Atlantic Refining Co. v. Railroad Commission, 346 S. W. 2d 801 (1961, Normanna case) 4, 9, 10

Brown v. Humble Oil & Refining Co., 126 Tex. 296, 83 S. W. 2d 935, 99 A.L.R. 1107 (1935) 2, 4

Brown v. Humble Oil & Refining Co., 126 Tex. 314, 87 S. W. 2d 1069 (1935) 3

Corzelius v. Harrell, 143 Tex. 509, 186 S. W. 2d 961 (1945) 4

Corzelius v. Harrell, 179 S. W. 2d 419 (1944) 4

Cramp v. Board of Public Inst., 82 S. Ct. 275 (1961) 6

D. C. Hall Transportation, Inc., 358 S. W. 2d 117 (1962) 10

Dailey v. Railroad Commission, 133 S. W. 2d 219 (Ref. 1939) 4

Edgar v. Stanolind Oil & Gas Co., 90 S. W. 2d 656 (Ref. 1936) 4

Federal Trade Commission v. American Tobacco Co., 274 U. S. 543, 47 S. Ct. 663 (1927) 6

Federal Trade Commission v. Standard Oil Co., 355 U. S. 396, 78 S. Ct. 369 (1957) 6

Flournoy v. Wiener, 321 U. S. 253, 64 S. Ct. 548 (1944) 6

Fox Film Corporation v. Muller, 296 U. S. 207, 56 S. Ct. 183 (1935) 6

Grayson v. Harris, 267 U. S. 352, 45 S. Ct. 317 (1924) 6

Page

Gulf Land Co. v. Atlantic Refining Co., 134 Tex. 59, 131 S. W. 2d 73 (1939) 2

Gulf Oil Corporation v. Smith, 145 S. W. 2d 280 (Ref. 1940) 4

Gulf Oil Corporation v. York, 134 S. W. 2d 502 (1939) 4

Halbouty v. Darsey, 326 S. W. 2d 528 (N.R.E. 1959) 4, 12

Halbouty v. Railroad Commission, 357 S. W. 2d 364 3

Hawkins v. Texas Co., 146 Tex. 511, 209 S. W. 2d 338 (1948) 3

Henderson v. Terrell, 24 F. Supp. 147 (T.J.C. 1938) 4

Herb v. Pitcairn, 324 U. S. 117, 65 S. Ct. 459 (1944) 6

Magnolia Petroleum Co. v. Blankenship, 85 F. 2d 553 (5 Cir. 1936) 4

Magnolia Petroleum Co. v. Railroad Commission, 93 S. W. 2d 587 (Ref. 1936) 4

Marrs v. Railroad Commission, 142 Tex. 293, 177 S. W. 2d 941 (1944) 4

Midas Oil Co. v. Stanolind Oil & Gas Co., 142 Tex. 417, 179 S. W. 2d 243 (1944) 9

Railroad Commission v. De Bardeleben, 157 Tex. 518, 305 S. W. 2d 141 (1957) 4

Railroad Commission v. Gulf Production Co., 134 Tex. 122, 132 S. W. 2d 254 (1939) 4

Railroad Commission v. Humble Oil & Refining Co. (Hawkins case), 193 S. W. 2d 824 (N.R.E. 1946) 4

Railroad Commission v. Magnolia Petroleum Co., 130 Tex. 484, 109 S. W. 2d 967 (1937) 4

Railroad Commission v. Sterling Oil & Refining Co., 147 Tex. 547, 218 S. W. 2d 415 (1949) 3

Index of Authorities—(Continued)

	Page
Railroad Commission v. C. Murel Williams, 356 S. W. 2d 131 (1961)	4
Republic Natural Gas Co. v. State of Oklahoma, 334 U. S. 62, 68 S. Ct. 972 (1948)	14
Texas Osage Coop Royalty Pool v. Clark, 159 Tex. 441, 322 S. W. 2d 506 (1959)	10
Thompson v. Consolidated Gas Utilities Corporation, 300 U. S. 55, 57 S. Ct. 364 (1937)	4
Thomas v. Stanolind Oil & Gas Co., 145 Tex. 270, 198 S. W. 2d 420 (1946)	3
Trapp v. Shell Oil Co., 145 Tex. 323, 198 S. W. 2d 424 (1946)	3
United States v. Johnston, 268 U. S. 220, 45 S. Ct. 496 (1925)	6
Ward Oil Corporation v. Overton Refining Co., 139 S. W. 2d 292 (Ref. 1940)	4
Wood v. Gulf Oil Corporation, 147 S. W. 2d 818 (Dis. C.J. 1941)	4
Art. 6008b, Texas Civil Statutes	11
Sec. 8, Art. 6049c, Texas Civil Statutes	2
Title 102, Vernon's Civil Statutes of Texas	2
Rule 483, Texas Rules of Civil Procedure	10

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Petition for a Writ of Certiorari
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Supreme Court of Texas

BRIEF OF RESPONDENT, PAN AMERICAN PETROLEUM CORPORATION, IN OPPOSITION

Pan American Petroleum Corporation is one of the Respondents in this case, the others being Michel T. Halbouty, Meredith & Company, and Peter Henderson Oil Company.

FUNCTION AND JURISDICTION OF THE RAILROAD COMMISSION OF TEXAS IN THE ADMINISTRATION OF THE OIL AND GAS CONSERVATION LAWS.

FUNCTION AND JURISDICTION OF THE TEXAS COURTS RELATIVE TO ORDERS ADOPTED BY THE RAILROAD COMMISSION OF TEXAS.

An understanding of the jurisdiction and power of the Railroad Commission of Texas and of the Texas courts in cases of this character will clarify the points to be considered by this Court.

Our oil and gas conservation laws in express terms constitute the Commission as the administrative agency charged with their enforcement. The Commission is charged with the duty and clothed with the power to make and enforce rules, regulations or orders for the conservation of oil and gas, and to prevent the waste thereof.[1]

Any interested party affected by the conservation laws relating to oil or gas, or by any rule, regulation or order of the Commission is authorized to file suit in the District Court of Travis County against the Commission to test the validity of such laws, rules, regulations or orders.[2]

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[1] *Title 102, Vernon's Civil Statutes of the State of Texas; Brown v. Humble Oil & Refining Co., 126 Tex. 296, 83 S. W. 2d 935, 941, 99 A.L.R. 1107 (1935); Gulf Land Co. v. Atlantic Refining Co., 134 Tex. 59, 131 S. W. 2d 73, 81 (1939).*

[2] *Sec. 8 of Article 6049c, Texas Civil Statutes. Brown v. Humble Oil & Refining Co., supra at 83 S. W. 2d 939.*

In a suit to test the validity of an order of the Commission, the scope of judicial review of the facts is governed by the substantial evidence rule, meaning, evidence introduced in court. In other words, the order of the Commission will be sustained if supported by substantial evidence and will be cancelled if illegal, unreasonable or arbitrary.[3]

It is a question of law as to whether or not an order of the Commission is reasonably supported by substantial evidence.[4]

If an order of the Commission is found to be illegal or invalid by a court of competent jurisdiction, such court may so adjudge. The court cannot substitute a new order for the one adjudged invalid. That power rests exclusively with the Commission. This well established principle of law is reannounced by the Supreme Court of Texas in this case.[5]

FAIR SHARE OF THE PRODUCTION.

In the case of *Gulf Land Co. v. Atlantic Refining Co.*, it is stated:

> "It is the law that every owner or lessee of land is entitled to a fair chance to recover the oil and gas in or under his land, or their equivalents in kind."[6]

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[3] *Thomas v. Stanolind Oil & Gas Co., 145 Tex. 270, 198 S. W. 2d 420, 421 (1946); Trapp v. Shell Oil Co., 145 Tex. 323, 198 S. W. 2d 424, 436 (1946); Hawkins v. Texas Co., 146 Tex. 511, 209 S. W. 2d 338, 340 (1948).*

[4] *Railroad Commission v. Sterling Oil & Refining Co., 147 Tex. 547, 218 S. W. 2d 415, 417 (1949).*

[5] *Halbouty v. Railroad Commission, 357 S. W. 2d 364, 373 (1960); Brown v. Humble Oil & Refining Co., 126 Tex. 314, 87 S. W. 2d 1069, 1070 (1935).*

[6] *134 Tex. 59, 131 S. W. 2d 73, 80 (1939).*

Similar language has been used in a variety of conservation cases extending over a period of 27 years,[1] and similar language was used in this case.[2]

The opinion in this case demonstrates that the Supreme Court of Texas, in great detail, considered and analyzed the evidence in the light of the "fair share" rule. It should be emphasized that the court relied to a great extent on the evidence of the Petitioners and particularly their Exhibits 21 and 22. Their Exhibit 22 shows that during the expected life of a well on a one acre tract, under the ⅓-⅔ formula, it would produce hydrocarbons (gas and condensate) of a value of $407,501, whereas, their Exhibit 21 shows that the value of the recoverable hydrocarbons underlying a one acre tract is of a value of $50,867. It is immediately apparent that hydrocarbons of a value in excess of $350,000 would be

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[1] *Brown v. Humble Oil & Refining Co., 126 Tex. 296, 83 S. W. 2d 935, 944, 99 A.L.R. 1107 (1935); Atlantic Oil Production Co. v. Railroad Commission, 85 S. W. 2d 655, 657 (W.E. Dis. 1935); Edgar v. Stanolind Oil & Gas Co., 90 S. W. 2d 656, 658 (Ref. 1936); Arkansas Fuel Oil Co. v. Reprimo Oil Co., 91 S. W. 2d 381, 383 (Ref. 1936); Magnolia Petroleum Co. v. Railroad Commission, 93 S. W. 2d 587, 588 (Ref. 1936); Magnolia Petroleum Co. v. Blankenship, 85 F. 2d 553, 555 (5 Cir. 1936); Railroad Comission v. Magnolia Petroleum Co., 130 Tex. 484, 109 S. W. 2d 967, 971 (1937); Thompson v. Consolidated Gas Utilities Corporation, 300 U. S. 55, 57 S. Ct. 364, 371 (1937); Henderson v. Terrell, 24 F. Supp. 147, 150, 152 (1938); Railroad Commission v. Gulf Production Co., 134 Tex. 122, 132 S. W. 2d 254, 255 (1939); Dailey v. Railroad Commission, 133 S. W. 2d 219, 221 (Ref. 1939); Gulf Oil Corporation v. York, 134 S. W. 2d 502, 505 (1939); Ward Oil Corporation v. Overton Refining Co., 139 S. W. 2d 292, 293 (Ref. 1940); Gulf Oil Corporation v. Smith, 145 S. W. 2d 280, 283 (Ref. 1940); Wood v. Gulf Oil Corporation, 147 S. W. 2d 818, 820 (Dis. C.J. 1941); Marrs v. Railroad Commission, 142 Tex. 293, 177 S. W. 2d 941, 948 (1944); Corzelius v. Harrell, 179 S. W. 2d 419, 425 (1944); Corzelius v. Harrell, 143 Tex. 509, 186 S. W. 2d 961, 966, 968 (1945); Railroad Commission v. Humble Oil & Refining Co. (Hawkins Case), 193 S. W. 2d 824, 832 (N.R.E. 1946); Railroad Commission v. De Bardeleben, 157 Tex. 518, 305 S. W. 2d 141, 143 (1957); Halbouty v. Darsey, 326 S. W. 2d 528, 532 (N.R.E. 1959); Atlantic Refining Company v. Railroad Commission, Tex. , 346 S. W. 2d 801, 808 (1961); and Railroad Commission v. C. Murel Williams, Tex. , 356 S. W. 2d 131 (1961).*

[2] *357 S. W. 2d at page 370.*

drained from others. The unreasonableness of such a drilling program is further demonstrated by Petitioners' Exhibit 21, which shows that the cost of drilling, equipping and operating a well would be $361,674. The Supreme Court of Texas concluded that the drainage to the 22 Rule 37 wells is tremendous, results in the confiscation of Respondent's gas, and makes it impossible for Respondent to recover its "fair share" of the gas.

Practically all of the evidence was highly technical, as the witnesses were either geologists or petroleum engineers. The record consists of three volumes of verbal testimony, and six volumes of exhibits, including numerous maps, charts, tabulations and cross-sections.

May it be emphasized in the strongest language possible that the basic issue in this lawsuit pertained to "fair share" of production. The decision of the Supreme Court of Texas was reached after it had thoroughly analyzed and weighed in great detail the voluminous technical evidence.

THE JUDGMENT OF THE SUPREME COURT OF TEXAS

Based on the above explanations, the judgment of the Supreme Court of Texas is very meaningful and a portion thereof reads as follows:

> "• • • it is considered, adjudged, ordered and decreed that Rule 3 of the 'Special Order Adopting Rules and Regulations for the Port Acres Field', No. 3-38395, entered by the Railroad Commission of Texas, was not

supported by substantial evidence and, therefore, is invalid and of no force and effect, * * *."[9]

WEIGHING THE EVIDENCE

In order for this Court to make a decision in regard to the basic issue of "fair share", it would be necessary for the Court to make a detailed study of this voluminous, highly technical evidence. This Court is not expected to weigh the evidence in a case of this character.[10]

NONFEDERAL QUESTION

It has been repeatedly stated by this Court that it will not review judgments of state courts that rest on adequate and independent state grounds.[11]

PETITIONERS DRILLED THEIR WELLS AT THEIR OWN RISK

(In Answer to Petitioners' Fourth Question)

After the discovery and completion of five wells in the Port Acres gas field, the Commission on August 18, 1958, adopted the ⅓-⅔ allocation formula. The trend of development was across an area consisting of more than 500 town-lots of less than one-half acre each. The interest of Respond-

[9]Page 88 of Petition for Writ of Certiorari.

[10]*Federal Trade Commission v. Standard Oil Co., 355 U. S. 396, 400, 78 S. Ct. 369, 371 (1957); Federal Trade Commission v. American Tobacco Co., 274 U. S. 543, 47 S. Ct. 663 (1927); United States v. Johnston, 268 U. S. 220, 45 S. Ct. 496, 497 (1925); Grayson v. Harris, 267 U. S. 352, 45 S. Ct. 317, 319 (1924).*

[11]*Fox Film Corporation v. Muller, 296 U. S. 207, 56 S. Ct. 183, 184 (1935); Flournoy v. Wiener, 321 U. S. 253, 64 S. Ct. 548, 552 (1944); Herb v. Pitcairn, 324 U. S. 117, 65 S. Ct. 459, 463 (1944); Cramp v. Board of Public Inst., 82 S. Ct. 275, 277 (1961).*

ent, Peter Henderson Oil Company, was primarily in the small tract area and it was successful in consolidating several hundred small tracts into drilling units in substantial compliance with the Commission's 160 acre unit rule. But there were a great number of small tracts which were not committed to any unit, and they presented a serious problem respecting the orderly development of the field. Henderson, on Novem'er 19, 1958, filed an application with the Commission requesting that the ⅓-⅔ allocation formula be amended. At a later date the other Respondents joined in this application.

It is appropriate to digress at this point to explain that the Commission has a well spacing Rule 37, which has been in force since 1919, and concerning which the appellate courts of Texas have written more than 300 opinions. Most oil and gas fields, including Port Acres, have a special spacing rule which is a variation of the statewide Rule 37. The Port Acres spacing rule provides for the location of wells 330 feet to any property, lease or subdivision line and 1320 feet to any other well. Obviously, a well could not be located on a one-half acre tract and comply with the spacing rule. But the rule permits the granting of exceptions to prevent waste or to prevent the confiscation of property. If an operator desires a well on a small tract, then a special procedure is required before the Commission consisting of (1) application, (2) notice, (3) hearing, and (4) the granting or denial of the drilling permit.

This explanation has been made about Rule 37 procedure in order to emphasize an important point in this case. At the

time the Henderson application was filed to amend the ⅓-⅔ allocation formula, one Rule 37 application was pending before the Commission. No Rule 37 application had been heard and, consequently, no permits had been granted. In other words, all of the Petitioners (small tract operators) in Port Acres pursued their Rule 37 applications, *obtained their permits, and drilled their wells after the Henderson application had been filed.*

These very pertinent undisputed facts explain the significant statement of the Supreme Court of Texas as follows:

> "So far as the appellees' complaint that a striking down of the ⅓-⅔ formula would probably entail heavy financial loss to them, it may be said that they drilled their wells at their own risk."[12]

There is no escape from the proposition that the above constitutes the holding of the Supreme Court of Texas on the subject of financial loss to the small tract operators.

The statement is made by Petitioners at pages 5 and 6 of their petition as follows:

> "The operational effect of the Texas Supreme Court's decision is that the Railroad Commission's proration rules, allocating allowables ⅓ per well—⅔ acreage for gas fields and ½ per well—½ acreage for oil fields, in many oil and gas fields in Texas, involving thousands of operators and investors, have been declared invalid, and that small tract owners' investment, running into millions of dollars, are subject to confiscation for the benefit of large tract operators, * * *."

This irresponsible statement, which is positively incorrect, was evidently made in an effort to alarm this Court.

[12] 357 S. W. 2d 376.

The Supreme Court of Texas, in one of its most recent decisions states in unmistakable language that *old* proration orders will not be disturbed.

> "We are in agreement with the reasoning of the courts in the Humble and Standard Oil Company cases in holding that where producers have acquiesced in and have failed to complain of the Commission's proration orders for a long period, during which time other operators have expended vast sums in exploration and drilling operations, such producers should not be heard to complain."[13]

THE COMMISSION OR COURTS CANNOT ASSURE THE PETITIONERS A PROFIT

(In Answer to Petitioners' Question No. 4

The Petitioners' fourth question presented for review is to the effect that Petitioners are entitled to "an allowable sufficient to give them a return on their investments."[14]

The Petitioners have cited as authority for the profit theory the case of *Railroad Commission v. Humble Oil & Refining Co.*, commonly referred to as the *Hawkins* case because it involved the Hawkins field.[15]

1. The portion of the opinion relied upon by the Petitioners is dictum.[16]

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[13] *Atlantic Refining Co. v. Railroad Commission, Tex. , 346 S. W. 2d 801, 811 (1961).* See also *Midas Oil Co. v. Stanolind Oil & Gas Co., 142 Tex. 417, 179 S. W. 2d 243 (1944).*

[14] Page 4 of the petition.

[15] *193 S. W. 2d 824 (Refused, No Reversible Error, 1946).*

[16] "From which it would seem that his allowable cannot be cut down to the point where his well would no longer produce, nor below the point where it could not be drilled and operated at a reasonable profit." *193 S. W. 2d at 832.*

2. The decision is by an intermediate appellate court, the Court of Civil Appeals. It is not the highest appellate court in Texas.

3. In the *Hawkins* case the Supreme Court of Texas "refused, no reversible error" the application for writ of error, thus meaning that it approved the judgment but not the opinion of the Court of Civil Appeals.[17]

4. The Supreme Court of Texas has expressly repudiated the profit theory in a very recent case.[18]

At Port Acres there are 500 separate and distinct tracts of less than one acre each. The recoverable reserves under a one acre tract, per the evidence of Petitioners, is of a value of $50,867, yet the mere cost of drilling a well is $275,000. Visualize the burden which would be placed on the Commission in trying to figure out how those 500 wells could make a profit. Such would be impossible, because gas in sufficient quantities does not exist at Port Acres. Is there any basis for favoring 22 tracts out of 500? If an allowable is granted the 22 wells which will insure a profit, then of necessity the other 478 tracts will be making a contribution toward the profit of the 22 tracts.

There is no authority in Texas, either legislative or court made, to the effect that the Commission has the power to allocate production for the deliberate purpose of making it possible for a small tract operator, large tract operator, or any other size operator to make a profit.

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[17] *Rule 483, Texas Rules of Civil Procedure; Texas Osage Coop Royalty Pool v. Clark, 159 Tex. 441, 322 S. W. 2d 506 (1959); D. C. Hall Transportation, Inc., Tex. , 358 S. W. 2d 117 (1962).*

[18] *Atlantic Refining Co. v. Railroad Commission, Tex. , 346 S. W. 2d at 810.*

THE OFFER OF UNITIZATION TO THE PETITIONERS

(In Answer to Questions Nos. 1, 2, and 3)

Following the quotation to the effect that the Petitioners drilled their wells at their own risk, the Supreme Court of Texas goes on to *comment* that:

> "There is some indication in the record by bill of exception that they offered unitization that would prevent confiscation and afford to them a fair share of the mineral proceeds from the common source."[19]

The court further comments that Texas has a statute which, although not compulsory, authorizes unitization.[20] Respondent desires to make the following explanation about the comments of the Supreme Court of Texas respecting unitization:

1. The opinion is not based on the offer of unitization.

2. The *judgment* of the Supreme Court of Texas does not mention the subject of unitization as charged by the Petitioners at page 3 of their petition.[21]

3. The opinion does not state that the Commission has the authority to compel unitization.

4. The opinion does not go so far as to suggest to the Commission that unitization might be a solution to the small tract problem.

5. The opinion does not go so far as to recommend unitization as being feasible or desirable.

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[19] *357 S. W. 2d at 376.*

[20] *Article 6008b, Texas Civil Statutes.*

[21] See page 87 of the Petition for a copy of the judgment.

6. The opinion does not say that Petitioners should have accepted the offer to unitize or that the Commission should undertake directly, indirectly or otherwise to force the Petitioners to unitize.

7. In the Supreme Court of Texas the Petitioners made an extensive argument to the effect that separate development of their tracts was essential and necessary. The opinion simply answered that fallacious argument by pointing out that unitization was probably available to them as a means by which they could recover their fair share of the gas. Unitization is not an evil thing. Several hundred small tracts were combined into the Henderson units.

8. The right of separate development is not an issue in this case. No one will question the validity of the Rule 37 drilling permits issued by the Commission to the Petitioners. No one will question the right of the Petitioners to drill and produce their wells. *The issue in this suit pertains to the amount of gas produced from the wells of Petitioners.* The validity of Rule 37 drilling permit which involves the right of separate development is a separate and distinct cause of action. The validity of a Rule 37 permit is all that was involved in the case of *Halbouty v. Darsey, 326 S. W. 2d 528.* The Petitioners have repeatedly referred to that as "the companion case." It will be obvious to the Court that it is not a companion case.

9. Finally and of extreme importance, is the fact that the courts of Texas could have done nothing about unitization.

The district court or Supreme Court have no authority to rewrite any order with or without unitization. The fact of it is, the Commission refused to give consideration to the offer to unitize. *Therefore, the administrative process has not been exhausted.* Everyone connected with this lawsuit knows that this entire matter will go back to the Commission for another hearing, after which a new allocation formula will be written. The question of unitization can then be considered and it can be safely said that the Commission or Respondents or, finally, the courts, will make no attempt to force the Petitioners into a unit.

THE MATTER IN CONTROVERSY HAS NOT REACHED THE POINT OF FINALITY

Although the judgment of the Supreme Court of Texas does not direct that the matter be referred back to the Commission, that is exactly the effect of the judgment. As has been pointed out, the district court or Supreme Court of Texas cannot write a new order and, consequently, they can do nothing about an (1) offer to unitize, (2) the fairness of an offer to unitize, or (3) whether unitization is to be forced on the Petitioners. The Commission, in the first instance and after another hearing, is the only tribunal authorized to rewrite the Port Acres allocation formula, and it is the only tribunal which can make the initial decisions about unitization.

It is obvious, therefore, that the judgment of the Supreme Court of Texas lacks that finality which will give this Court jurisdiction.[22]

WHEREFORE, Respondent, Pan American Petroleum Corporation, prays that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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[22] *Republic Natural Gas Co. v. State of Oklahoma*, 334 U. S. 62, 68 S. Ct. 972 (1948).

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